DOW THEORY LETTERS INC.

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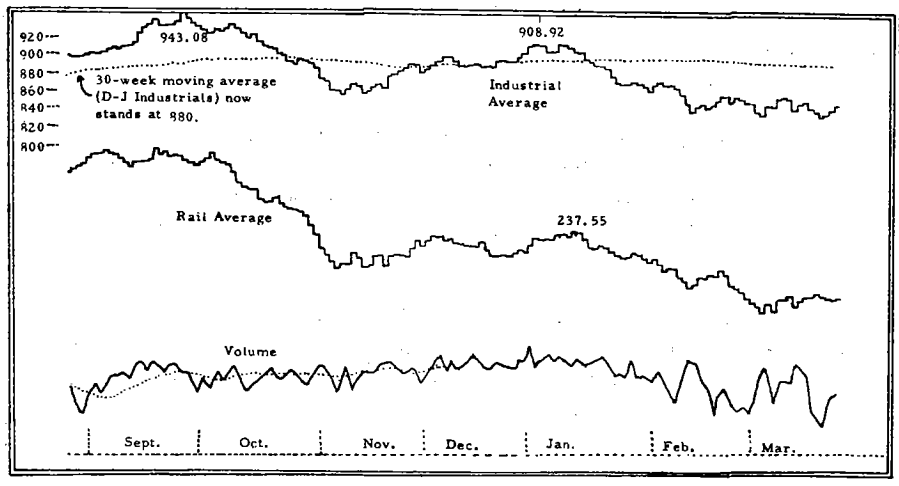
THE MARKET: Our regular subscription list has enlarged substantially over the past few months, the number of trial-subscriptions to this service has surged to record levels. This is gratifying, of course, but it also makes me a bit apprehensive. I am aware that business tends to gravitate (in the investmen advisory field) towards those analysts who happen to be right at the moment— and it is this "at the moment" which makes me nervous.

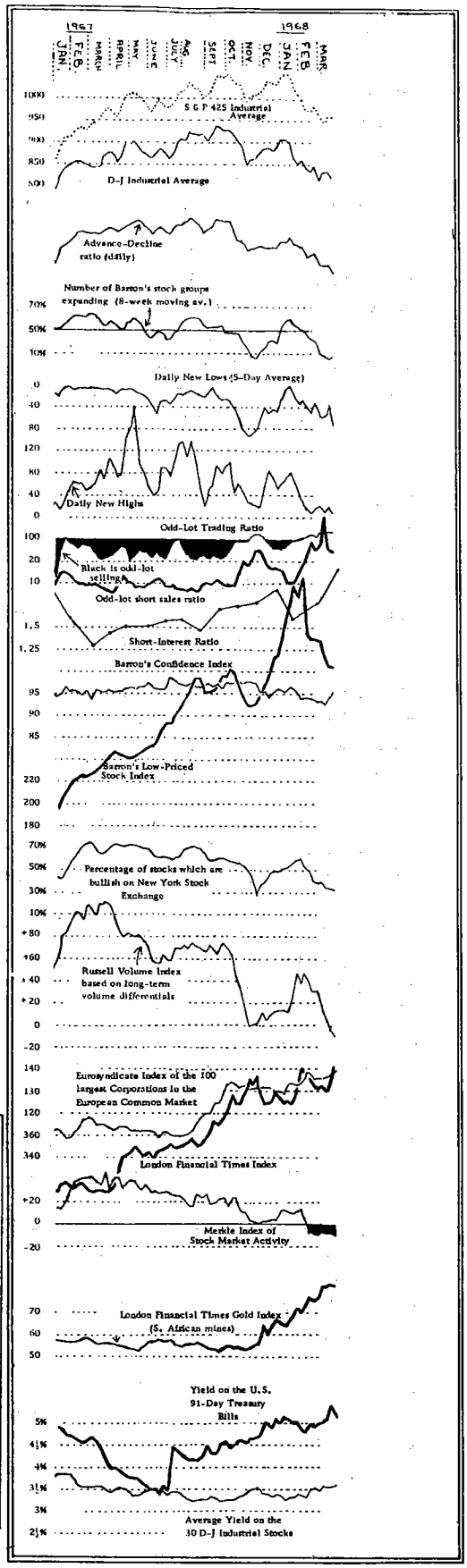
Although my fellow analysts hate to admit it, Wall Street "crystal ball gazing" is a matter of batting averages. No one is ever consistently right on the short term, a minority of advisors are usually right on the intermediate term, and only a handfull of writers are persistently correct on the long term.

I attach by far the most importance to an analyst's proper interpretation of the long term or primary trend of the market, and I do feel that I have been right in my interpretations of the primary trend. But even this can be rather frustrating. It can be frustrating because neophyte subscribers expect something approximating daily perfection, and there simply is no such thing in the market. Neophytes expect advance notice of every ten point advance or decline (regardless of the primary direction of the market), and I have never been ready to even attempt this sort of nonsensical guessing game. Furthermore, as stated many times before, I have found that most non-professional traders (even those who confine their trading to the intermediate swings) tend to come out with thinner bank accounts over any extended period of time. Therefore, I must say that in my experience success comes to those with the patience and fortitude to stay fully invested throughout bull markets and fully liquid throughout bear markets.

We are in a primary bear market now, and I firmly believe that most of today's "jump in-jump out" traders are going to be taken by the bear. Most readers who have ignored my advice regarding avoiding this bear market are now sustaining losses in part or all of their portfolios. They are waiting for the "big rally" in order to get out. Some of the unpleasant facts are now making the headlines, and everyone is worrying to some extent. Even our President (as this interesting clip from

> NEW YORK — Man About Town: LBJ's top worry (outside of Vietnam) is the low Dow Jones averages "for the next five months" . . .




1967
1968
S & P 425 Industrials Average
D-J Industrial Average
Advance-Decline ratio (daily)
Number of Barron's stock groups expanding (8-week moving av.)
Daily New Lows (5-Day Average)
Daily New Highs
Odd-Lot Trading Ratio
Black is odd-lot selling
Odd-lot short sales ratio
Short-Interest Ratio
Barron's Confidence Index
Barron's Low-Priced Stock Index
Percentage of stocks which are bullish on New York Stock Exchange
Russell Volume Index based on long-term volume differentials
Eurosyndicate Index of the 100 largest Corporations in the European Common Market
London Financial Times Index
Merkle Index of Stock Market Activity
London Financial Times Gold Index (S. African mines)
Yield on the U.S. 91-Day Treasury Bills
Average Yield on the 30 D-J Industrial Stocks

 Walter Winchell's March 22 column testifies) is upset about the Dow. But worries and Presidential pronouncements are not going to deter the bear. The primary downtrend is in effect, and as each month goes by, values are decreasing.

We are beginning to see some of the fundamentals underlying this bear market. We can see them in high interest rates, monetary chaos, international suspicions, political, social and racial turmoil. And we are beginning to see some of the problems for industry, particularly the steel business. For instance, I was most interested in this paragraph from economist Elliot Janeway's latest Letter: "But demoralization bordering on panic is the only description we can find for the present phenomenon of steel market distress at the very phase of the labor cycle when every expectation born of experience and based on common sense would have argued for a return, however briefly and treacherously, to seller's market conditions. If the return to distress buyer's market conditions does not represent an urgent warning signal, we don't know what does. The state of affairs in the steel market is entering a hard, pragmatic dissent to the unrestrained and uncompromising bullishness of the President's principal economic advisers."

The pressure is now on the U.S. (pressure brought on by its European creditors) to tighten our belts. Our creditors are asking us for budget cuts, tax increases, monetary restraints and higher interest rates. This is all very well, but 1968 is an election year, and although LBJ can promise our creditors the moon, the fact is that there are grave doubts regarding his ability (and Congress's desire) to deliver. It is certain that the promise vs. delivery battle will constitute one of the most significant political and financial situations of 1968. For failure to make good on his promises (and I, personally, believe LBJ is half-hearted about his promises anyway) is going to bring consternation and fear to Europe. And the stock market is not going to be immune to the results.

* * * *

On Wall Street itself, the market, following a drop (in the Dow) from the 1968 high of 908.43, is appraising the situation ahead. As seen on the page 1 chart of the Averages, there is much confusion and uncertainty. On March 5 the Industrials and Rails sank to 1968 lows of 827.03 and 214.58 respectively. A minor rally ensued, but this was quickly followed by divergence with Rails tending to rise while Industrials declined. This type of schizophrenic action (i.e. divergence) on the part of the Averages is always a "yellow light" as far as the market is concerned. Divergence is often, but not always, a sign of impending danger in the price structure.

On March 21 Industrials broke below their March 5 level—to a new low for 1968. The penetration, however, was not confirmed by the Rails. The question now is—will Rails continue to hold (i.e. refuse to confirm), thereby setting the stage for the next significant upward correction? Or does the Industrial decline to a new 1968 low presage the next major downward leg of the bear market?

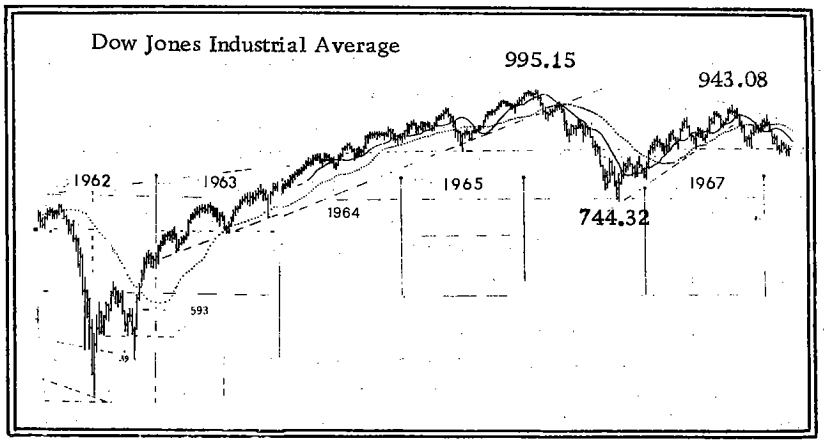
Although there has been a lack of dramatic action since our last mailing, a few items are worthy of comment. The D-J Utility Average, on March 25, broke below its 120.67 low of 1967, thereby sinking to the lowest level since the 118.96 low of 1966. I consider this continuing bearish action by Utilities to be very adverse for the general market.

A second item which few analysts have noticed is the action of the low-priced stocks as evidenced by Barron's Low-Priced Stock Index (see page 1 chart). The L-P Index touched a high of 400.8 on January 22. Here are the figures in the ten weeks since January 22. 385.5, 383.0, 356.4, 349.1, 347.8, 347.7, 335.0, 325.8, and for the latest week ending March 22 the Index ended at 325.2. This means that the L-P Stock Index has now dropped for 10 weeks in a row since the January high. I consider this action typical and characteristic of the beginning of a speculative collapse. So far the decline has been undramatic but steady. Sooner or later we will see a downside breakaway in the L-P stocks, and a decline in these issues to dramatic lows. All this is typical of a long, eroding type bear market.

On the page 1 chart also notice that the Merkle Index is at a new 1968 low of minus 12, while the Russell Volume Index is negative for the second week at minus 9. Neither of these bodes well for the current market.

THE TOP: The accompanying (semi-logarithmic or ratio scale) chart on page 3 traces the path of the D-J Industrial Average from 1962 to date. The chart is worth studying carefully. Here we see the remarkable discounting ability of the market. Perhaps as early as 1964 the market foresaw hints of the multitudinous dangers which now confront our nation. For the 1964 high for the Dow was 891.71, the 1965 high for the Dow was 969.26, the 1966 high was 995.15 the 1967 peak was 943.08 and this year's top was 908.92.

Currently, the Industrial Average is below any of its peaks of the past five years. The inference is that as long as five years ago, the market sensed danger and began to protect itself through the process of careful distribution. The fact that the Dow is now below any of its peaks of the past five years despite persistent inflation, an expanding war, and a steadily increasing public participation is the more remarkable. What other conclusion can we arrive at except that massive distribution has been occurring?



But a second remarkable phenomenon bears study. It is also worthy of note that although the Dow is now below all its peaks of the past five years, and although a primary bear market has been in progress since February, 1966, the Dow has never really crumbled. True, the 1966 bear market low (a low which still stands) was the 744.32 bottom of October, 1966. This was 251 points below the 1966 bull market high of 995.15. At present, however, the Industrial Average is in the 840 area, which is approximately 155 points below the 1966 high. Thus the Industrials more than two years after the bull market top are still struggling against disaster, still trying to avoid the crash-type action which has accompanied so many bear markets. But Industrials, nevertheless, are still nearer the bear market low than the high.

What comes next? I see two overall major forces exerting themselves on this market, and it would be well to discuss them. The first might best be explained by repeating the words of a friend who called me from New York City last week. This man is one of my oldest friends, a successful partner in a small but prominent Wall Street member firm. This is what he said: "You know, I believe the Dow Theory, and I believe it is saying that the primary trend is down. Personally, I have been combing the lists in an attempt to find a few good or intelligent investments. You're aware that I'm never all bearish or all bullish, and I always have to come up with something to interest my customers. But today I'm really having trouble. I simply can't find anything very attractive. The former 'good merchandise,' the stuff I like and the merchandise that has a story, why those stocks just have not come down far enough to make me nibble on them. I confess I want to go into something, but I'm having a devil of a time. Maybe the market hasn't declined far enough.

"But one thing bothers me. You know, there is a mass of money sitting onthe sidelines. There are still an awful lot of millionaires who are now out of the market and in Treasury bills, and they've kept a huge amount of their money. According to you, shouldn't these guys be 'taken' by the bear market before this thing is over? Dick, there are just too many of these fellows around. Maybe they have to go in once more, and maybe the market will then cave in with all the new millionaires caught up to their necks in stocks. It just bothers me that there is so much money around, and in a safe place. If this market collapses from here, it's not going to hurt these people. I wonder if we are not going to rally again and bring in all the smart bears."

My answer was that I simply did not know. I respect this man's opinions, and I respect his observations and information. I know that each bull and bear market works differently, and the years 1949 to 1966 saw the greatest and most extended bull market in history. Therefore, it would not surprise me to see the bear market which began in 1966 ultimately become one of the worst and most extended bear markets in history. I don't know how events are going to unfold, I don't know how long it is going to take to erase the inflationary and speculative excess of a $16\frac{1}{2}$ year bull market.

Already, we have seen all the gold backing removed from what was once the world's greatest currency. We have seen history's greatest gold run, and a trumped-up, stop-gap two level price system instituted for gold. We are witnessing the highest interest rates in a generation, we are seeing national and student unrest, riots, racial strife, the most unpopular war in U.S. history, an incumbent President struggling to retain the nomination of his own party. We are seeing violent anti-Americanism among such "friendly" nations as Sweden, France, Japan, and West Germany, we are facing a possible massive escalation of the Vietnam war (with a potential confrontation of China) as our President desperately attempts to "win" the interminable war and get it out of the way prior to election time. Where only a few years ago our President was talking about his Great Society and boundless prosperity, he is now saying, "We don't ask anybody else to surrender.....but we don't plan to pull out either. And we don't plan to let people influence us, pressure us, and force us to divide our nation in a time of national peril. The hour is here."

We are in a primary bear market, and those who understand Dow's Theory know that a bear market means troubles and a compounding of troubles until the bear market ends. At the top of page 4 is a tabulation showing the high and low closing for the Industrial Average since 1949. Most people are so engrossed in details and fuzzy arguments that they fail to comprehend the big picture during a bull or bear market.

One fact of these Dow tabulations is apparent. During the entire 1949 to 1966 bull market, there were only two instances in which the Dow did not better a previous year's high during the following year. These two instances were the 1957 failure to better the 1956 high (a 28¢ miss) and the 1962 failure to better the 1961 high (an 8.9 point miss). But it is important to

note that in both instances these failures were remedied during the second year. Thus, during 1958 the 1956 high was bettered. And during 1963 the 1961 high was bettered.

Then we come to the bull market top of 1966 at 995.15. The 1967 high failed to better the 1966 high by 52.07 points, the worst miss since 1949. And with the 1968 peak of 908.92 still standing, we have again failed to better the 1966 high, this year (so far) by 86.23 points. If the 1966 high of 995.15 is not surpassed in 1968, it will represent the first time since 1949 that the Dow has failed to better a peak in either the following year or the second succeeding year. This is something new, and few are aware of this important fundamental situation.

What happened in previous primary bear markets? The 1946 bull market peak of 212.50 stood for four years before it was bettered. The 1937 peak of 194.40 stood for eight years before it was bettered. And the great bull market peak of 1929 (381.17) stood for a quarter of a century before it was finally bettered in 1954. No one knows how long the 1966 peak will stand, but I would guess that it could hold for many years to come.

	—Industrials—	
	High	Low
1967	943.08	786.41
1966	995.15	744.32
1965	969.26	840.59
1964	891.71	766.08
1963	767.21	646.79
1962	726.01	535.76
1961	734.91	610.25
1960	685.47	566.05
1959	679.36	574.46
1958	583.65	436.89
1957	520.77	419.79
1956	521.05	462.35
1955	488.40	388.20
1954	404.39	279.87
1953	293.79	255.49
1952	292.00	256.35
1951	276.37	238.99
1950	235.47	196.81
1949	200.52	161.60

DOLLAR BAROMETER: The two-tier gold system which has now been established has a history of not working. Few of today's young Wall Streeters are aware that the world had a two-tier system from the end of World War II until 1960, when the Gold Pool was formed. But there was a major difference between those days and today. In "the old days" the U.S. enjoyed a vast hoard of over $25 billion in gold, in sharp contrast to the present new low of $10.5 billion of U.S. gold (lowest level since 1935).

Back in the 1940's and 1950's the incentive to hold gold was never too strong, except in countries which were deficit-ridden. There, worried investors who were suspicious of their own currencies would hedge by buying gold at the going pirce. But the U.S. dollar was all-powerful then, and the great majority of nations and individuals never had any qualms about holding dollars against gold.

In 1949 South Africa set a price of $38 an ounce for newly mined gold, and this obviously annoyed the International Monetary Fund. It was bothersome because the fund realized that if the free market price of gold should climb too high, many currencies would fall under suspicion. The suspicion began a year later. In 1950 when the Korean War started the price of gold shot to $50 an ounce, then quickly dropped back in the face of the huge American gold hoard and the devaluation of the pound (which, in effect, boosted S. Africa's price for gold and helped push S. African gold output skyward).

The two-tier gold system continued in the face of I.M.F. worries, and in 1960 nagging suspicions were realized when on Oct. 21, 1960, the free market price of gold jumped a record $5 in a day to $40. The market was showing dramatic doubts regarding the value of the dollar. The U.S. and England immediately flooded the market with gold in order to knock down the price, but the meaning of the 1960 gold run was clear. The following year the Gold Pool was formed for the express purpose of holding the price of gold at $35. Thus gold, the monetary barometer, was pegged. The dollar barometer, in effect, has been smashed.

All during the 1960's, in the face of horrendous U.S. deficits, suspicions continued to grow regarding the stability of the dollar. Those suspicions took the form of gold purchases by foreign central banks and gold hoarding by individuals. The gold rush had started.

A gold rush obviously meant steady losses of gold by the members of the Gold Pool. The Pool stoically kept feeding gold to the buyers. But finally, in March, 1968, the gold rush became a panic. The spendthrift Great Society, the mounting U.S. deficits and the Vietnam war, the flight from dollars to gold became too much for even the Gold Pool to handle. On the weekend of March 17 the Gold Pool was disbanded and the world returned to the two-tier gold system. The former Gold Pool members announced that they would insulate themselves against further gold speculation by trying to "live" on their current supply of $35 gold. They thus affected disdain for gold and the free gold market.

History says that this policy will not work—unless the dollar again becomes impregnable. First, as long as the free market gold price is above $35, central bankers will be tempted to turn in new dollars for U.S. gold at $35 an ounce. They will ponder ways (of course they are not supposed to do this) of disposing of the $35 gold at a free market profit. And as someone recently stated, there are alot of crooks in this world, and some of them are central bankers.

Secondly, we again have a sensitive barometer of dollar sentiment. The U.S. dollar is again "on display," and doubts about our intentions to eliminate the deficit will be translated into run-ups in the price of gold. No longer will U.S. administrations be allowed to inflate while holding the price of gold at a synthetic $35 per ounce. The free gold market will talk—loud and clear.

Thirdly, the present floating price of gold also means a floating free market sentiment regarding the dollar's value (since the dollar is defined as a value equal to one thirty-fifth of an ounce of gold). A floating value for dollars is bad enough, but in the face of dozens of possible devaluations today, the price of international trade will become very expensive indeed. In fact, on March 21 the Wall Street Journal in a front page article discusses the multifarious and expensive actions which corporations are now being forced to take in order to hedge against possible devaluations anywhere and everywhere. In the face of this, it can be expected that international trade in general is going to suffer. And it is going to contract. Corporate energies are going to be diverted to speculating against currencies rather than towards business itself. As Alden Wells put it in his newest report, "Banking and other short-term funds require a precision of cost down to the last decimal point. If the (London) futures market cannot provide accurate costs, normal activities dry up and are replaced by speculative activities."

Last week it was reported that Kuwait and the other Arab oil-producing nations are meeting to debate whether they should now accept regular U.S. dollars for oil or whether they will demand payment in dollars pegged to the free market price for gold. The fact is that as long as the free market price for gold is above $35 per ounce, why in the world would the Arab nations or any other nation want to accept dollars based on $35 gold? This is just one problem which is going to crop up with the two-tier gold system. But it is an immediate one, and it is going to cause a good deal of trouble in the months ahead.

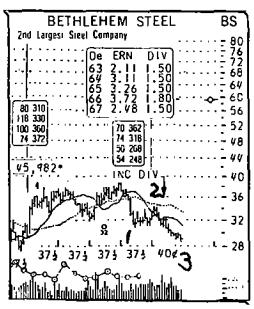
WHAT'S AHEAD? I was most interested in an interview in the April 1 issue of U.S. News & World Report. The interview was with Professor L. Albert Hahn, international monetary authority. "What is being experienced today," stated Professor Hahn, "is nothing other than the reward for 30 years of currency mismanagement." The next question and answer are reproduced below.

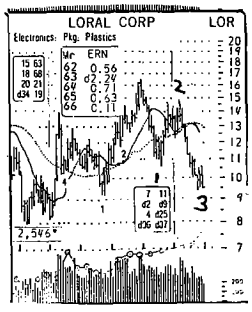
> **Q** What needs to be done now?
>
> **A** My answer is rather simple and self-evident: A genuine anti-inflationary, if not deflationary, policy should be applied in the U. S. until the balance of payments is restored.
>
> Such programs were applied with great success in Italy, France and Germany in 1965 and 1966.

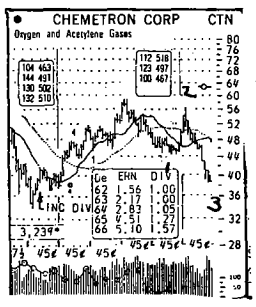
This is obviously the type of thinking insisted upon by the U.S.'s European creditors during the recent Gold Pool talks. This is what our creditors expect of us now. But note the reference to the success of France and Germany with deflation during 1965 and 1966. I want to comment on this. As far as Dow Theorists are concerned, it is most important to realize that the French and German deflations of 1965 and 1966 occurred within the framework of an international primary bull trend.

But the primary trend turned down in February, 1966. Deflation, if attempted by the U.S. now, will take place within the framework of a primary bear market. I believe that the results will show a major difference in that people will be amazed at the consequences of any 1968-69 deflation vs. the French and German deflations of 1965-66. The results may well show up first in the stock market, which, in anticipation, is currently well down from its 1966, 1967 or 1968 highs. But it will also show in unexpected weakness in the economy. At any rate, this is something to watch in the period ahead as the U.S. embarks on the required (and promised) deflationary program.

DOW THEORY MARKET LABORATORY PAGE



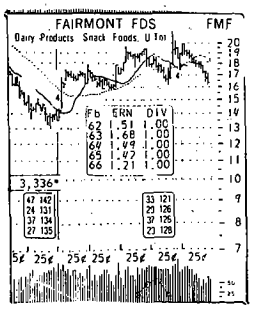


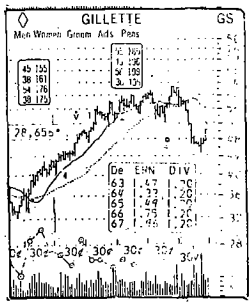


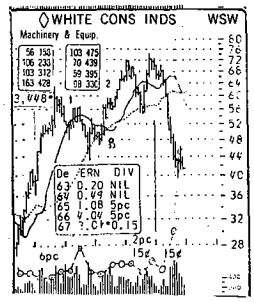
In studying all stocks on the N.Y.S.E., it is immediately apparent that the majority of individual issues are in downtrends. What is most interesting, however, is the numerous stages of downtrends which can now be seen.

In general, I have attempted to classify these declining phases according to the number of legs or whether a top is now being formed. I believe the accompanying charts (courtesy of Quote Digest, 110 N. Lorraine, Wichita, Kansas) will be of help in classification.

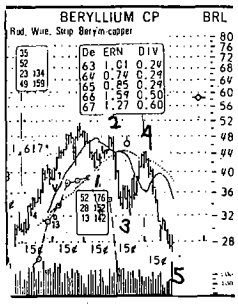
The first group, represented by Fairmont, Gillette and White Consolidated seems to be in the first phase of decline. Note that each of these issues have broken down from a high, and that each has probably completed a single leg down. In the case of Fairmont, the first leg has failed to break below the preceding bottom, and this stock is showing a good deal more strength than the other two. In fact, unless or until Fairmont breaks below its preceding bottom, it can still be classified as being in an uptrend.

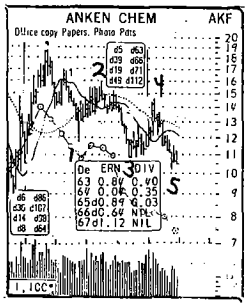


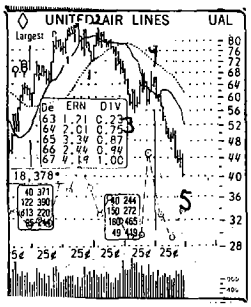


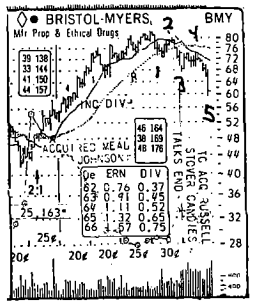


The second group represented by Bethlehem Steel, Loral Electronic and Chemetron are in or have completed two legs down. These are the legs numbered 1 and 3 on the charts. My guess is that these stocks will probably rally forming a leg 4 which will be below leg 2, and then a 5th leg will complete the downward phase prior to a more important correction than has so far been seen. Note here that Bethlehem and Chemetron look particularly bearish, while Loral appears slightly better since it is holding as its previous support around 9.









In the third group of stocks we see what appears to be 5 completed legs, three legs down and 2 upward corrections. It is interesting that the 5 legs in Bristol Myers were rather shallow, and only leg 5 provided a "plunging" look. Nevertheless, the 5 legs in Bristol failed to erase as much as half of the preceding major advance, and this makes Bristol look considerably stronger than a stock such as United Airlines. Here we see 5 legs which may be completed. But United has lost over 50% of its value in this major decline, and the stock has obviously been one of the weakest on the Board. It is a particular sign of weakness that the 5th leg in United was so violent in comparison to the much milder 5th leg in say Anken Chemical.

CONCLUSION: A number of stocks appear to have completed major downward correction, and these are seen in the last or 5-leg groups. Others are in earlier corrective stages. However, in general it would not be surprising to see the broad market move up from here, since so many 1, 3 and 5 (downward) legs appear to have been completed.

Analyzing these stocks from the student standpoint is one thing, but "playing" these stocks for an upward correction is quite another. I consider speculation for rallies in a bear market to be extremely dangerous, and I again warn subscribers that "bear markets are made to part people from their money." Study the upward correction on the individual charts shown on pages 5 and 6, and then figure how you would have fared with "in-and-out" operations. In most cases, it would have been extremely difficult. I will make one last comment, however. If I had to speculate for an upward correction, I would prefer buying into the third group than any of the others. In other words, I would prefer buying a stock which has undergone 5 completed legs (3 down and 2 up). These are the issues which should go into the most important upward corrections, since the first phase of their bear markets have probably been completed. Do not use this statement as a recommendation. I still state that the safest way to operate in a primary bear market is to avoid it. The odds are that for every two times you make a right move, you will have to face three instances wherein you make a wrong move. And that costs money.